COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

At Richmond, MARCH 31, 1999

PETITION OF

KENTUCKY UTILITIES COMPANY
d/b/a/ OLD DOMINION POWER COMPANY

CASE NO. PUE960303

For injunctive relief and/or
declaratory judgment against
Powell Valley Electric Cooperative

FINAL ORDER

On November 21, 1996, Kentucky Utilities Company ("KU"), doing business in the Commonwealth as Old Dominion Power Company, filed a Petition requesting that the Commission enjoin Powell Valley Electric Cooperative ("PVEC") from selling or delivering electric power to Sigmon Coal Company, Inc. ("Sigmon") for use at mining operations in KU's Virginia service territory or declare that PVEC's provision of such service violates the Utility Facilities Act.[1]

As discussed below, the Petition was assigned to a Hearing Examiner, who, after a hearing and briefs, granted PVEC's motion to dismiss on the basis that the Commission lacked jurisdiction over the matter. For the reasons discussed herein, we reject the Examiner's findings regarding our jurisdiction. We find that there is no basis for PVEC's assertion that we do not have the authority to decide this case. Further, we will grant KU's Petition as we find that PVEC's provision of electric service to Sigmon operations in KU's service territory in Virginia violates Virginia law.

[1] Va. Code § 56-265.1, *et seq.*

Background

PVEC is an electric cooperative incorporated in Virginia that provides retail electric service in southwestern Virginia and northeastern Tennessee. PVEC purchases its power at wholesale from the Tennessee Valley Authority ("TVA")[2] for retail distribution to its members.

KU is an investor-owned electric utility incorporated in Kentucky and Virginia. KU provides electric service in five counties in southwestern Virginia and in parts of Kentucky, including Harlan County.

Both PVEC and KU provide service in Lee County, Virginia. Lee County borders Harlan County, Kentucky, and is southeast of the Virginia-Kentucky border. The boundary between the Virginia service territories of PVEC and KU runs southeasterly from the state line into Lee County, and then northeasterly, to form a "V" shape immediately south of Calvin, Virginia. KU's service territory is in and to the north of the "V" and PVEC's service territory is immediately south of the "V."

The Sigmon mining operations are located on properties in Lee County and Harlan County, covering approximately 13,120 acres. Sigmon does not own these properties but has mineral leases that give it the rights to the coal and the surface where coal is mined. In Virginia, the area controlled by Sigmon spans the Lee County service territories of both KU and PVEC. Our jurisdiction over this matter addresses the retail electric service provided to Sigmon mining operations in Virginia and does not, of course, extend to service provided in Kentucky.

The material facts of this case are not in dispute.

In 1985, Sigmon acquired mineral rights to properties located near Calvin in Lee County and across the Virginia-Kentucky border in Harlan County. From 1985 to 1992, KU exclusively served Sigmon's mining operations in Lee County from KU's Calvin substation and in Harlan

[2] The TVA is an entity created by Congress pursuant to the Tennessee Valley Authority Act, 16 U.S.C. §§ 831 *et seq.* The sale of the TVA's surplus power is subordinate to its primary purposes of promoting the navigation, and controlling the floodwaters, of the Tennessee River system. *Tennessee Valley Authority v. Ashwander*, 78 F.2d 578 (5th Cir. 1935), *aff'd*, 297 U.S. 288 (1936) ("*Ashwander*").

County from KU's Keokee substation. The Calvin substation served no load other than Sigmon's mining operations within KU's Virginia service territory.[3]

PVEC also has provided service to Sigmon in PVEC's service territory at least since 1985. Specifically, PVEC furnished electricity to two mines in the "Belcher Mine" area, located in Lee County, Virginia. Sigmon suspended operations in the Belcher Mine area in 1994.[4] Currently, the only activity in PVEC's service territory that requires electricity for Sigmon operations is at the "Harlan Seam mine." The mine itself is idled but electricity is required for the running of fans and pumping of water.[5]

In 1992, Sigmon decided to construct a new coal preparation plant ("Preparation Plant") located in KU's service territory near Calvin, Virginia (hereinafter, the "Calvin area"). In May of 1992, PVEC approached Sigmon about the possibility of serving additional load for Sigmon, including the Preparation Plant.[6] PVEC proposed to furnish such electricity from a single, consolidated delivery point (the "Sigmon Delivery Point") that would be located in PVEC's territory immediately south of the PVEC/KU boundary.[7]

The Preparation Plant was placed into service in early January of 1993. Initially, KU served the plant. Sigmon installed a private distribution system and, on January 18, 1993, Sigmon disconnected the Preparation Plant's load from KU's system and connected it to PVEC's system. This marked the first time PVEC provided service to Sigmon for use in KU's service territory, a load of approximately 1 MW.[8] PVEC's facilities in that area, however, were unable to handle the Sigmon load in addition to its preexisting load on the same PVEC circuit and, later in that month, Sigmon transferred part of its load back to KU.[9]

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[3] KU's Keokee substation, located in Virginia, provided service to part of Sigmon's mining load as well as to the community of Keokee, Virginia.

[4] Ex. RWM-5 at 11. The two mines in this area were closed in 1990; apparently, other activities associated with mining operations continued until 1994. *Id.*

[5] Tr. at 181-82, 198-200, 203.

[6] Ex. RWM-5 at 8-9.

[7] *Id.* at 9-10.

[8] Tr. at 60.

[9] RMH-1 at 7; Tr. at 57-60, 145-47.

On May 11, 1993, KU formally requested PVEC to discontinue providing service to Sigmon. By letter dated May 20, 1993, PVEC sought an advisory opinion from the Commission's Staff whether such service was lawful. On July 21, 1993, Staff sent a letter stating that, based on a telecommunications case,[10] PVEC's provision of service to Sigmon in KU's service territory did not violate Virginia law since PVEC would transport power and energy to a delivery point within PVEC's service territory.[11]

As stated, PVEC experienced difficulties in serving the Sigmon load it took on in January of 1993. PVEC concluded that it needed to build a new substation in the Calvin Area in order to serve Sigmon's growing load and other customers previously served by another PVEC substation. PVEC and KU had discussed building such a substation since 1992. Such construction, however, could not commence unless KU agreed to supply the necessary transmission service since PVEC and the TVA have no transmission lines in that area.[12] KU states that the TVA contacted KU in December of 1993 to discuss building PVEC's new substation and that KU was informed that the substation was needed to serve projected residential and commercial loads, not Sigmon's mining operations in KU's service territory.[13] On April 1, 1995, KU and the TVA negotiated an interconnection agreement that increased the amount of capacity that PVEC could deliver to the Calvin area by approximately 5 MW.[14]

In April of 1996, PVEC began constructing a new, high-capacity substation ("the Keokee Substation") at the northern boundary of its service territory located in closest proximity to the Sigmon mining operations in KU's service territory.[15] The new substation is immediately south of the "V" that is formed by the PVEC-KU boundary. Also in 1996, Sigmon contracted for the construction of a 34.5 kV subtransmission line.[16] That line runs northward from the boundary of

[10] *Commonwealth ex rel. Citizens Tel. Coop. v. C&P Tel. Co. of Va*., 1984 S.C.C. Ann. Rept. 354.
[11] Staff correctly stated in the letter that its finding did not represent a binding Commission adjudication.
[12] RMH-1 at 9-13; Tr. at 56-57.
[13] RMH-1 at 10, 14-15.
[14] Ex. RWM-5 at 14. *See also* Tr. at 60
[15] Ex. RMH-1 at 14-15; Ex. RWM-5 at 9. Thus, both KU and PVEC have substations in the area referred to as the "Keokee" Substation.
[16] Ex. RMH-1 at 16; Tr. at 172-73.

KU's and PVEC's service territories to the Calvin area, and then across the Virginia-Kentucky state line to Sigmon's mining operations in Kentucky.

In July of 1996, construction of PVEC's Keokee Substation was largely completed and placed in service. The substation enabled PVEC to serve the entire remaining Sigmon load in Virginia and in Harlan County, Kentucky, a load of approximately 5 MW. PVEC's Keokee Substation serves as a wholesale delivery point for PVEC's receipt of power purchased from the TVA. PVEC delivers power from this substation to the Sigmon Delivery Point, from where it is transported over Sigmon's subtransmission line to Sigmon mining operations in KU's Virginia and Kentucky service territories. PVEC asserts that the Keokee Substation is approximately 300 feet from the Sigmon Delivery Point, but, according to KU, the distance is roughly 50 feet.[17]

On or about October 12, 1996, Sigmon was disconnected from KU's system and PVEC became the sole source of power for Sigmon's mining operations formerly served by KU. KU states that PVEC's "capture" of the Sigmon load resulted in completely idling KU's Calvin substation and also idling much of KU's Keokee substation.[18]

On November 21, 1996, KU filed the petition initiating this proceeding.

The Commission entered an order on December 13, 1996, in which it made PVEC a party to this proceeding and appointed a hearing examiner to conduct all further proceedings in this matter. The Commission directed the parties to file a stipulation of agreed upon facts and a list of legal issues in dispute on February 21, 1997, and legal briefs on March 21, 1997.

On January 21, 1997, PVEC filed an Answer to the Petition.

After several extensions at the requests of both KU and PVEC, the Examiner directed the parties to file their joint stipulation of facts and list of legal issues in dispute by October 1, 1997, and to file briefs on the disputed legal issues by October 31, 1997.

On November 12, 1997, KU filed a motion to establish a procedural schedule for the filing of testimony and to schedule an evidentiary hearing.

[17] Tr. at 176, 236-37.
[18] Tr. at 267-68.

On November 21, 1997, approximately a year after KU's Petition was filed, PVEC filed a motion to establish a procedural schedule and a motion to dismiss KU's Petition. PVEC asserted that the Commission lacked jurisdiction over this matter because the TVA is a party to the contract underlying the dispute and the TVA's participation "clothes the contract with an overriding federal interest that precludes state regulation."[19] PVEC argued that because the TVA is free from state regulation and control, and Sigmon and PVEC are parties to a contract with the TVA, so too are Sigmon and PVEC free from state regulation or control that would interfere with the performance of the contract.

On December 12, 1997, the Examiner issued a Ruling taking the Motion to Dismiss under advisement and established a procedural schedule.

The hearing in this matter was held on March 12, 1998, before Hearing Examiner Howard P. Anderson, Jr. Representing KU were Kendrick R. Riggs and Richard F. Newell, and counsel for PVEC were William C. Carriger, Mark W. Smith, Donald M. Schubert, Calvin F. Major and David H. Stanifer. The Commission's Staff was represented by C. Meade Browder, Jr.

On October 19, 1998, the Examiner issued his Report. The Examiner noted that in a recently issued order,[20] the Commission had considered a case involving a similar situation. The Examiner stated that the primary distinction between the two cases is that, in this case, "Sigmon is purchasing its power from the TVA, a federal entity."[21] The Examiner stated that under §§ 56-265.3 and 56-265.4 of the Code of Virginia, the certificated utility has an exclusive right, and duty, to serve customers within its service territory boundaries. He found that, in this case, unless the point of delivery test is applied,[22] PVEC would be in clear violation of the Utility

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[19] PVEC Motion to Dismiss at 3.

[20] *Petition of Prince George Elec. Coop. and Petition of RGC (USA) Mineral Sands, Inc. and RGC (USA) Minerals, Inc.*, __ S.C.C. Ann. Rep. __, Case No. PUE960295, Document Control No. 980630278 (June 25, 1998) ("*Prince George*").

[21] Hearing Examiner's Report at 10.

[22] Under the point of delivery test, a utility may sell electric power to a customer as long as the delivery (or metering) point is located within that utility's service territory, even through the electric power is subsequently transported to, and consumed in, another utility's service territory. *See Prince George*, slip op. at 5.

Facilities Act by providing power to a customer, Sigmon, for its use in another utility's service territory. The Examiner found that the TVA's authority to propose resale rate schedules "cannot be limited by state legislatures."[23] Further, the Examiner found that "enforcement" of the Utility Facilities Act in this case would "result in significant interference with, and perhaps nullification of the contract between the TVA, PVEC and Sigmon."[24] The Examiner therefore granted PVEC's motion to dismiss.

KU filed comments on the Hearing Examiner's Report taking exception to the Examiner's recommendation that PVEC's Motion to Dismiss be granted. KU argues that the Examiner's jurisdictional finding is "based on an erroneous understanding of the relationship of the parties to the contract, as well as a misinterpretation of applicable law."[25] KU states that there are two distinct contracts at issue; one between PVEC and Sigmon, and the other among PVEC, Sigmon and the TVA. KU states that the Examiner's conclusion that the Commission lacks jurisdiction over this matter rests on the erroneous view that Sigmon is buying power from the TVA. Pointing to several provisions in the three party contract, KU contends the plain language of the contract demonstrates it is PVEC, not the TVA, that is obligated under that contract to sell and deliver power to Sigmon. KU states that this case involves PVEC's ability to resell power, from whatever source it was obtained, for use outside of PVEC's service territory, not the earlier sale from the TVA to PVEC.[26]

KU argues that there is no implied preemption in this case either as a matter of law or based on the facts of this case. KU first contends there is no implied preemption because it has long been recognized that the regulation of retail electric utility service territories is an area of traditional state concern and regulation. KU states that federal law is not preempted unless Congress's intent to preempt is clear and manifest, and neither the plain language of the TVA Act, nor its legislative history indicate such intent.[27] KU argues that implied preemption does

[23] Hearing Examiner's Report at 11.
[24] *Id.*
[25] Comments of KU on the Hearing Examiner's Report at 6.
[26] *Id.* at 10-11.
[27] *See id.* at 23 n.18 (discussing legislative history).

not occur in this case because PVEC can comply with both the Utility Facilities Act and the TVA Act, so there is no conflict between the two statutes. Moreover, PVEC's compliance with Virginia's requirement of exclusive service territories does not create an impediment to achieving the goals of the TVA Act.

KU points out that PVEC has acquiesced to, and sought the protection of, the Commission's jurisdiction since the Utility Facilities Act was passed, and operates under certificates of public convenience and necessity granted by the Commission. KU notes that the TVA itself has recognized that its distributors are established and regulated by state, not federal, law. KU quotes from an affidavit submitted by a TVA Vice President, R. Larry Taylor, in an action filed against it in Alabama, in which he states that the TVA's distributors, including rural electric cooperatives, "operate under the laws of the States in which they do business and each has a defined geographic service area, as set forth under State law, in which it is the exclusive retail supplier of electricity."[28]

Beyond the jurisdictional issue, KU maintains that PVEC's provision of service to Sigmon's mining loads in KU's service territory violates the Utility Facilities Act, duplicates existing facilities, and causes KU to suffer direct and immediate harm.

Staff filed Comments on the Report of the Hearing Examiner objecting to the Examiner's jurisdictional finding. Staff states that PVEC and the Examiner mischaracterize the nature of KU's petition. According to the Staff, KU is not asking the Commission to exert jurisdiction over a TVA contract. Instead, it is simply asking the Commission to define the legal parameters of electric utility retail service territories required by Title 56 of the Code of Virginia and enforced by the Commission.

Staff asserts that, "the Report is conspicuously absent of any direct legal authority to support its finding that the TVA Act preempts the Commission from enforcing the Facilities Act

[28] *Id.* at 31-32, citing Ex. 7 to Ex. RMH-1 at 5. Further, Mr. Taylor states that the "degree of competition allowed in retail markets (i.e., service to ultimate customers) is in general considered a matter of State and local concern." *Id.* at 3. He also states that "[r]estrictions on retail competition do constrain [purchasers' of TVA power] ability to sell power (whether or not that power was originally purchased from TVA) to ultimate customers in the [purchasers'] service areas." *Id.*

against [PVEC]."[29] Staff states that federal preemption is not presumed unless there are positive indications of such intent by Congress, and that neither the TVA Act nor its legislative history indicates any such positive indication.[30] Staff contends that there is no preemption of any kind in this case, whether express or implied. Citing two cases upholding state taxation of TVA distributors, discussed *infra*, Staff states that "[i]t is clear that the mere existence of a TVA contract cannot insulate a TVA distributor from all state regulations."[31]

Staff points out that the only reference to service territories in the TVA Act is found in §15d, 16 U.S.C. § 831n-4, which established geographic limits within which the TVA may sell surplus power, i.e., the "TVA fence." Staff states that Congress's intent in adding this provision when it amended the TVA Act in 1959 was to protect private utilities from TVA competition.[32] Staff states that the fact that Congress determined the limits within which the TVA may sell power based on historical retail service territory boundaries of TVA distributors demonstrates that Congress recognized the states' authority over service territories of retail electric suppliers.

PVEC filed Comments to the Hearing Examiner's Report. PVEC maintains that the Examiner appropriately found that the Commission lacks jurisdiction over this matter because the contract underlying this dispute is a three party contract among PVEC, Sigmon and the TVA. PVEC argues that the Commission has no authority to regulate a contract to which the TVA is a party since the TVA is a federal corporation over which the Commission has no authority.[33] PVEC asserts that the Supremacy Clause of the United States Constitution[34] provides two different bases upon which to find that the Commission is preempted in this matter. First, PVEC contends that "under general preemption principles, the Supremacy Clause protects the contracting decisions of TVA that are made in accordance with the TVA Act from interference

[29] Comments of Commission Staff on Hearing Examiner's Report at 5.
[30] *Id.* at 6-7, citing *California Div. of Labor Stds. v. Dillingham Constructr*., 519 U.S. 316 (1997); *New York State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co*., 514 U.S. 645 (1995); *Rice v. Santa Fe Elevator Corp*., 331 U.S. 218 (1947) ("*Rice*").
[31] Comments of Commission Staff on Hearing Examiner's Report at 9.
[32] *Id.*, citing *Hardin v. Kentucky Util. Co.*, 390 U.S. 1, 7 (1968) ("*Hardin*").
[33] Comments of PVEC to Hearing Examiner's Report at 3-4.
[34] U.S. Const. art. VI, cl. 2.

from state law."[35] Second, PVEC argues that the "Supremacy Clause grants TVA and its contracting parties intergovernmental immunity from the application of state law to TVA's contracting decisions."[36] PVEC urges the Commission to adopt the Examiner's recommendation that PVEC's Motion to Dismiss be granted.

On December 17, 1998, KU filed a motion requesting leave to file supplemental comments to address an issue, intergovernmental immunity, that KU states PVEC raised for the first time in its comments. KU requested that its supplemental comments, filed with its motion, be admitted into the record or, alternatively, that PVEC's comments on this issue be stricken from the record.

On December 28, 1998, PVEC filed a motion to strike KU's December 17 motion; alternatively, it requested permission to file a response to the comments.

On January 7, 1998, KU filed a reply to PVEC's December 28, 1998 pleading, urging the Commission to deny PVEC's request to file further comments.

By Order dated January 14, 1999, the Commission granted KU's December 17, 1998 Motion, denied PVEC's December 28, 1998 Motion to Strike, and provided PVEC an opportunity to file supplemental comments addressing only the issue of intergovernmental immunity. PVEC filed such comments on January 22, 1999.

NOW THE COMMISSION, upon consideration of the record and the Hearing Examiner's October 19, 1998 Report, the comments and exceptions thereto, and the applicable statutes and case law, is of the opinion and finds that KU's petition should be granted. We find that we have jurisdiction over this matter and that PVEC's sale of electric power to Sigmon for use at its mining operations in KU's Virginia service territory violates the Utilities Facilities Act.[37]

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[35] Comments of PVEC to Hearing Examiner's Report at 8.
[36] *Id.* at 11.
[37] Section 56-265.3 of the Utility Facilities Act requires a public utility to obtain a certificate of public convenience and necessity authorizing it to provide such service in a particular territory. Under § 56-265.4, no applicant for a certificate may operate in the territory of any holder of a certificate unless and until it is proved to the Commission's satisfaction that the service being rendered by the certificate holder is inadequate to the requirements of the public

The threshold issue is whether this Commission has jurisdiction to decide this matter. As stated, the Examiner found that the Commission lacks jurisdiction over this dispute since it involves a "three party contract" among PVEC, Sigmon, and the TVA. The Examiner recognized that the Commission has jurisdiction under the Utility Facilities Act to determine the service territories of utilities operating within Virginia and that the TVA Act does not expressly preempt state territorial laws.[38] Nevertheless, the Examiner concluded that:

> Enforcement of Virginia's Utility Facilities Act, in this instance, would result in significant interference with, and perhaps nullification of the contract between the TVA, PVEC and Sigmon. Based on the authority cited above and the TVA's federal authority to enter into contracts for the sale of its power, I find that the contract between the TVA, Powell Valley, and Sigmon Coal cannot be limited by this Commission.[39]

We find the Examiner's analysis flawed in several respects.

The first flaw concerns the factual basis for the Examiner's conclusion that the Commission is preempted in this matter. The Examiner focused on the contractual relationships among PVEC, the TVA, and Sigmon. As stated, he characterized the transaction at issue as a sale of power from the TVA to Sigmon "pursuant to a contract between the TVA, PVEC and Sigmon."[40] That is wrong.

In fact, this dispute involves two contracts that set forth the relationships of these parties. By the express terms of both contracts, PVEC agrees to sell to Sigmon, and Sigmon to purchase, firm and interruptible power.

The first contract, dated March 1, 1996, is between only PVEC and Sigmon ("PVEC/Sigmon Contract"). This contract sets forth the terms and conditions under which firm

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necessity and convenience. Further, the certificate holder must be given a reasonable time and opportunity to remedy any inadequacy before a certificate will be granted to the applicant.

[38] Hearing Examiner's Report at 6.

[39] Hearing Examiner's Report at 11. The authorities referred to in the quoted language were cited by the Examiner apparently in support of the proposition that the "U.S. Supreme Court and the lower federal courts have held, based on the supremacy clause of Article VI of the United States Constitution, that the TVA's board's authority to propose resale rate schedules cannot be limited by state legislatures." *Id.* at 10-11. As discussed below, the TVA's authority to establish the rates for the sale of surplus power is not the issue in this case.

[40] Hearing Examiner's Report at 10.

and interruptible power and energy will be made available by PVEC for Sigmon's purchase and use at its coal mining, treatment, and loading facilities in Virginia. The TVA is not a party to this contract.

The second contract, also dated March 1, 1996, is among PVEC, Sigmon and the TVA ("PVEC/Sigmon/TVA Contract"). This contract sets forth the terms and conditions under which PVEC will sell power, including economy surplus power ("ESP"), to Sigmon. It provides that, "the parties wish to agree upon the terms and conditions under which firm and interruptible electric power and energy will be made available by [PVEC] for the operation of [Sigmon's] said facilities."[41] Section 2 of the contract states that, "[i]n addition to firm power, [PVEC] shall make available ESP Option C in such amounts as TVA, in its judgment, is able to supply, up to and including 7,100 kW."[42] Thus, by the express terms of the contract, PVEC, not the TVA, is selling firm power and ESP to Sigmon.

Further, the PVEC/Sigmon/TVA Contract makes clear that the TVA is a party only for a limited purpose. The contract states that:

> It is expressly recognized that [Sigmon] remains a customer of [PVEC] and is not a directly served customer of TVA. TVA is a party to this contract only because of the unique nature of ESP. [PVEC] retains responsibility for all power service and customer relations matters except as provided otherwise with respect to ESP.[43]

The contract provides that the TVA, upon proper notice, may suspend the availability of ESP "at any time and from time to time."[44] The contract also provides that if the ESP provisions are terminated for any reason, the TVA shall cease to be a party to the contract and the contract shall be deemed to be exclusively between PVEC and Sigmon.[45] In addition, certain of the contract's

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[41] Power Supply Contract Among Powell Valley Cooperative, Sigmon Coal Company, Inc. and Tennessee Valley Authority ("PVEC/Sigmon/TVA Contract"), contained in Ex. RWM-5, Ex. 14 at 1.
[42] *Id.* at 2.
[43] PVEC/Sigmon/TVA Contract, "Terms and Conditions," section 3.1. For example, PVEC has the sole responsibility for installing, operating, and maintaining any additional or replacement meters and associated facilities. *Id.*, section 2.3.1.
[44] PVEC/Sigmon/TVA Contract, ESP Attachment, section D.
[45] PVEC/Sigmon/TVA Contract, "Terms and Conditions," section 3.

provisions give the TVA certain operational rights concerning the delivery of ESP to the ultimate customers. For example, the contract gives the TVA (and PVEC) the right of access in, over, and across Sigmon's property as is "reasonably necessary or desirable" for installing, operating and maintaining meters and associated equipment,[46] and gives the TVA the right to communicate directly with Sigmon about matters relating to ESP.[47]

Because the PVEC/Sigmon/TVA contract specifically states that Sigmon is PVEC's customer and makes clear that the TVA is a party only for a limited purpose, we cannot but conclude that this contract embodies PVEC's agreement to sell firm power and ESP to Sigmon. Therefore, contrary to the Examiner's conclusion, Sigmon is not purchasing power from the TVA. Rather, both contracts, by their terms, provide for PVEC's sale of power to Sigmon. The TVA's sale of ESP to PVEC does not enter into our analysis because the issue before us is not whether the TVA may lawfully sell surplus power to PVEC (that is, we are not concerned with the wholesale sale from the TVA to PVEC), but whether PVEC may sell such power to Sigmon outside of PVEC's certificated service territory (*i.e.*, whether the retail sale from PVEC to Sigmon is lawful).

With respect to PVEC's legal analysis, we find that PVEC provides no authority to support its assertion that the Supremacy Clause bars the Commission's review of this dispute. As discussed, PVEC argues: (1) that the Commission is preempted by the TVA Act; and (2) that PVEC is shielded from state regulation by virtue of its participation in a contract to which a federal entity is a party (*i.e.*, its intergovernmental argument).

First, we disagree with PVEC that we lack jurisdiction over this matter on the basis of implied preemption.[48] Implied preemption may occur when: (i) there is an explicit conflict between federal and state laws; (ii) compliance with state law and federal law is impossible or the state statute forms an obstacle to the accomplishment and execution of Congressional

[46] *Id.*, section 2.4.
[47] *Id.*, section 3.2.
[48] The Examiner correctly found that the TVA Act does not expressly preempt state territorial laws. Hearing Examiner's Report at 6.

objectives; (iii) Congress has enacted a scheme of federal regulation so pervasive that one may reasonably infer that Congress left no room for States to act; or (iv) there is an implicit barrier to state regulation in the federal law.[49] Based on our review of the Utility Facilities Act and the TVA Act, we find no basis upon which to infer implied preemption in this case.

The TVA Act grants to the TVA Board authority to sell surplus power not used in its operations to retail electric providers (the TVA "distributors") and "to include in any contract for the sale of power such terms and conditions, including resale rate schedules, and to provide for such rules and regulations as in its judgment may be necessary or desirable for carrying out the purposes of this Act."[50] The Act also places limitations upon the geographic area in which the TVA may sell its power, often referred to as the "TVA fence" or "TVA wall."[51]

The Constitution of Virginia and Titles 12 and 56 of the Code of Virginia authorize the Commission to regulate the service of electric cooperatives, such as PVEC, in the Commonwealth.

While it is clear that the TVA has jurisdiction over the rates, terms, and conditions for the sale of surplus TVA power, we find that it is equally clear that Congress did not intend that the TVA Act supplant or displace traditional state regulation of retail electric utilities, including state territorial law. Rather, ample authority establishes that Congress intended that the TVA Act merely supplement state regulation of retail electric providers. Significantly, for example, Congress specifically requires the TVA to give entities desiring to purchase TVA power "ample time to fully comply with any local law now in existence or hereafter enacted providing for the necessary legal authority" prior to entering into a contract with the TVA for the sale and purchase of such power.[52]

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[49] *Pacific Gas and Elec. Co. v. State Energy Resources Conservation & Development Comm'n*, 461 U.S. 190, 203-05 (1983) ("*PG&E*"); *Jones v. Rath Packing Co*., 430 U.S. 519, 525-26 (1977); *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 (1963); *Rice*, 331 U.S. at 229-230; *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).
[50] 16 U.S.C. § 831i.
[51] 16 U.S.C. § 831n-4.
[52] 16 U.S.C. § 831k.

In addition to the express language of the statute, the TVA Act addresses the sale of surplus power only insofar as it provides the TVA authority to sell such power and to establish the rates, terms and conditions for sales of surplus power that "in its judgment may be necessary or desirable for carrying out the purposes of this Act."[53] Other than the TVA's authority to establish the rates, terms and conditions for the surplus power, the Act is silent with respect to any other manner of regulation of the service of TVA's distributors, including the determination of service territories. Therefore, determinations regarding the geographic areas within which TVA distributors may provide retail service must be made with reference to state law, as is the case for all retail electric providers.

The regulation of the service of retail electric providers has long been recognized to be one of the functions associated with the police powers of the states.[54] The United States Supreme Court recognized the states' authority to determine retail service territories, including territories of TVA distributors, in an early TVA case, stating that "[w]hether competition between utilities shall be prohibited, regulated or forbidden is a matter of state policy."[55] Further, as stated earlier, the TVA itself recognizes that decisions concerning the areas that surplus power may be sold by TVA distributors to ultimate customers are a matter of state concern.[56]

Moreover, there is a strong presumption that federal law does not preempt areas traditionally subject to the police power of the states.[57] In an early TVA case in which the Supreme Court clarified that the TVA may lawfully sell its surplus power as long as it is done in an appropriate way, the Court stated that it must assume that such sales will "be consistent with

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[53] 16 U.S.C. § 831i.

[54] *See PG&E*, 461 U.S. at 205-06 (1983); *Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of New York*, 447 U.S. 557, 569 (1980).

[55] *Tennessee Electric Power Co. v. Tennessee Valley Authority*, 306 U.S. 118, 141 (1939) (where state statute did not confer upon public utilities the exclusive right to provide service in their territories, competition of the TVA did not constitute an invasion of the utilities' charter or franchise rights so as to give them standing upon which to challenge the constitutionality of the TVA Act).

[56] *See supra* n. 28 and accompanying text.

[57] *See New York State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645 (1995); *Gregory v. Ashcroft*, 501 U.S. 452 (1991); *Rice*, 331 U.S. at 229-231.

the foundation principles of our dual system of government and must not be contrived to govern the concerns reserved to the States."[58] As Staff and KU point out, courts have found no conflict between state authority to impose taxes on TVA distributors, notwithstanding the TVA's jurisdiction over the rates, terms and conditions charged by such distributors.[59] Indeed, the Commission assesses gross receipts taxes upon PVEC for its sales within Virginia. Apparently, under PVEC's view, electric suppliers can freely circumvent Virginia's requirement of exclusive service territories simply by purchasing their wholesale requirements from the TVA. We do not believe that Congress intended to provide electric providers the means to achieve such manipulation of state law.

Further, PVEC's compliance with the Utility Facilities Act does not frustrate the purpose and objectives of the TVA Act; nor does the TVA Act form an implicit barrier to state regulation. PVEC's compliance with state law, restricting its sales of power purchased from the TVA to within its service territory, is not inconsistent with the TVA Act's limitation on the areas in which the TVA may sell its surplus power. Nor, based on the facts before us, does PVEC's compliance with state law preclude the TVA from entering into a contract with PVEC for the sale of power. While it is true that PVEC's compliance with Virginia's requirement of exclusive service territories will limit PVEC to selling power purchased from the TVA (or any wholesale supplier) to within its service territory, nothing in the TVA Act requires or permits the TVA to orchestrate the capture of others' retail load for its distributors.

PVEC's argument, carried to its logical conclusion, would have federal law override state law any time the application of state law would impede or preclude TVA distributors from selling power purchased from the TVA. Federal law does not support this conclusion, and such a result would be entirely inconsistent with the 1959 amendment to the TVA Act that, in essence,

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[58] *Ashwander*, 297 U.S. at 338 (holding that the TVA did not exceed its constitutional powers in selling electricity produced at its dams in excess of that which the TVA created in the course of executing its governmental functions, or in acquiring transmission lines in order to sell such power).

[59] *See City of Arab v. Cherokee Elec. Coop*., 673 So.2d 751, 753-55 (Ala. 1995) (TVA distributors created and operating under Alabama law are not exempt from state taxation by virtue of their contracts with the TVA); *North Georgia Electric Membership Corp. v. City of Calhoun*, 450 S.E.2d 410 (Ga. 1994), *cert. denied*, 514 U.S. 1109 (1995) (Electric supplier not exempted from state taxation by virtue of relationship with the TVA).

froze the areas in which TVA power could be sold to protect investor owned utilities from competition from the TVA.[60]

We agree with the Staff and KU that the cases relied upon by the Hearing Examiner uphold only the TVA's exclusive jurisdiction over determining the rates, terms and conditions of the sale of surplus power and its freedom from state regulation or control when engaging in activities in furtherance of its legitimate statutory purposes, including authority to enter into contracts with private companies and utilities. As discussed above, the issue before us is not whether the TVA may establish the rates, terms and conditions for the resale of surplus power, but whether PVEC's sale of power, regardless of the source, is lawful when made to a customer whose load is located in KU's service territory. No party in this proceeding questions the TVA's authority to establish the rates for the sale of its surplus power.[61]

PVEC's second argument is that "[t]he Supremacy Clause grants the TVA and its contracting parties intergovernmental immunity from the application of state law to TVA's contracting decisions."[62] PVEC asserts that, under the doctrine of intergovernmental immunity, the Commission cannot take any action that would directly regulate, interfere with, or place a limitation on the TVA's contracting decisions.[63] The authorities relied upon by PVEC involve state attempts to directly regulate or exert control over federal government programs or policies, or employees of the federal government acting within the scope of their governmental functions.

This argument is also unavailing. The purport of the doctrine of intergovernmental immunity is to preclude direct state regulation of the federal government, without the federal

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[60] *Hardin*, 390 U.S. at 7 ("[I]t is clear and undisputed that the protection of private utilities from TVA competition was almost universally regarded as the primary objective of the [1959] limitation [in § 831n-4]."). *See also Alabama Power Co. v. Tennessee Valley Authority*, 948 F. Supp. 1010, 1014, 1021-22 (N.D. Ala. 1996). Moreover, KU cites legislative history indicating Congress's intent that state law be respected with regard to the distributors' service territories. KU Comments to Hearing Examiner's Report at 23. n. 18. For example, Congress intended that the TVA and its distributors would invoke the TVA Act's provision with "extreme caution" in order that they "not encroach on" the service territories of investor owned utilities. *Id.* (citing 1959 U.S.C.C.A.N. 2000, 2008).

[61] The Commission has long recognized that it has no authority to alter or limit the rate schedules propounded by the TVA Board. *See Application of Powell Valley Electric Cooperative*, Case No. PUA870069, Document Control No. 871110227 (Nov. 9, 1987).

[62] Comments of PVEC on the Hearing Examiner's Report at 11.

[63] *Id.* at 11-19.

government's express consent.[64] The Commission's decision will not result in directly regulating or exerting control over the TVA. As discussed, this case is about PVEC's sale of power to Sigmon, not the TVA's previous sale of power to PVEC, and our decision to limit PVEC to providing retail service in its certificated service territory will regulate only PVEC.

PVEC cannot, and does not, provide any legal support for its assertion that the TVA's immunity extends to PVEC simply because of its participation in a contract to which the TVA is a party. The Supreme Court has stated that the federal government's immunity from state regulation does not extend to those who merely contract to furnish supplies or render services to the government.[65] Rather, intergovernmental immunity may be conferred only "upon the United States itself or an agency or instrumentality so closely connected to the Government that the two cannot realistically be viewed as separate entities."[66] PVEC clearly is not an instrumentality of the federal government and the fact that PVEC entered into a contract to which a federal entity is a party does not magically transform it into a federal entity. Moreover, immunity will not be conferred even if the regulation has an effect on the federal government or if the federal government would shoulder the economic burden, as long as the regulation is not discriminatory.[67] The enforcement of the Utilities Facilities Act in this case will not discriminate

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[64] *See Hancock v. Train*, 426 U.S. 167, 178-80 (1976); *Johnson v. Maryland*, 254 U.S. 51, 57 (1920). We note that the Supreme Court has observed that this "doctrine" has been poorly understood and inconsistently applied. *United States v. New Mexico*, 455 U.S. 720, 580, 589 (1982) (doctrine of intergovernmental immunity "has been marked from the beginning by inconsistent decisions and excessively delicate distinctions.") ("*New Mexico*"); *United States v. City of Detroit*, 355 U.S. 466, 473 (1958) (the area of intergovernmental tax immunity is a "much litigated and often confused field") ("*Detroit*").

[65] *See New Mexico*, 455 U.S. at 734 (contractors doing business with the federal government under an "advanced funding" procedure are not exempt from state tax because contractors cannot be termed "constituent parts" of the federal government and their relationship with the government was created for a limited, carefully defined purpose); *United States v. Boyd*, 378 U.S. 39, 48 (1964) (rejecting Government's claim that government contractors were tax exempt because they were federal agents); *Penn Dairies, Inc. v. Milk Control Comm'n*, 318 U.S. 261, 270-71 (1943) (intergovernmental immunity will not be extended beyond the federal government itself and governmental functions performed by its officers and agents) (citations omitted).

[66] *New Mexico*, 455 U.S. at 735.

[67] *See Detroit*, 355 U.S. at 471-74 (the federal government's immunity from state taxation is not violated by a state statute imposing a tax on a party using tax exempt real property of the federal government in a business conducted for profit, as long as it does not discriminate against the federal government or those with whom it deal*); United States v. State Corp. Comm'n of Virginia.*, 345 F. Supp. 843, 846-48 (E.D. Va. 1972), *aff'd*, 409 U.S. 1094 (1973) (State Corporation Commission not precluded by doctrine of intergovernmental immunity from imposing same rate schedule on the Pentagon as local residential subscribers, even though the United States will pay substantially more. (citations omitted)).

against the federal government or PVEC since all retail electric providers in the Commonwealth are allowed to provide service only within their service territories, regardless of the identity of their supplier.

Turning to the merits of this case, although the parties dispute certain details concerning the history of Sigmon's service, the material facts of this case are not in dispute. Based on these facts, the result required by Virginia law is clear and unequivocal.

Under the Utility Facilities Act, only an electric provider that has applied for and obtained a certificate of public convenience and necessity is allowed and, indeed, has the responsibility to provide electric service to a customer requesting service within a particular service territory. In *Prince George*, the Commission addressed a similar situation. In that case, a customer sought to purchase power from an electric provider ("Utility A") other than the utility certificated to provide service in the area in which the customer's mineral processing plant was located ("Utility B"). To this end, the customer purchased a strip of land 4,380 feet by 30 feet that extended into the service territory of Utility A. Utility A delivered the power to a metering point the customer owned on the 30 foot strip of land within Utility A's service territory; from there, the power was delivered through the 4,380 foot corridor over the customer's privately owned distribution line to the customer's plant in Utility B's service territory. The customer argued that Utility A's provision of service did not violate the Utility Facilities Act since the electricity was delivered to a point within Utility A's service territory prior to its delivery to the customer's plant in Utility B's service territory.

The Commission disagreed. We found that the relevant provisions of the Virginia Code, §§ 56-265.3 and 56-265.4, "provide for exclusive service territories that should be afforded significant protection."[68] The Commission found that if customers are allowed to manipulate delivery points to avoid the electric supplier for their area, the utility would be left with an obligation to serve its entire service territory, but with no assurance that it would be allowed to do so. The Commission stated that "[s]uch circumstances make planning for and serving the

[68] *Prince George*, slip op. at 16.

remaining customers more difficult and can increase costs for both the utility and its remaining ratepayers."[69] The Commission explained that although it was not adopting an absolute test and would consider the practical realities of each situation, we intended to "ensure that our decisions enforce the Code's requirement of strong protection for the exclusive service territories of utilities in Virginia."[70]

We find that the facts of this case weigh even more strongly against allowing a customer to switch electric providers through manipulating its delivery point than was the case in *Prince George*. In *Prince George*, the customer seeking to avoid the service provider for its area was a new customer with new load; therefore, the incumbent utility would not have suffered economic detriment due to a loss of existing revenue. In this case, Sigmon was an existing customer of KU. PVEC constructed facilities to serve Sigmon that duplicated existing facilities of KU. KU states that the migration of KU's Sigmon load to PVEC resulted in idling KU's Calvin substation and at least half of its Keokee substation and connecting transmission capacity. KU states that the loss of Sigmon's load is costing it approximately $1 million per year. KU also states that if the Commission decides in favor of PVEC, PVEC will have an incentive to "cherry pick" more of Sigmon's lucrative mining loads, potentially resulting in $6 to $8 million of lost revenues in Virginia alone.[71] Further, KU states that the loss of its mining revenues would strand roughly $7.3 million KU has invested in transmission and substation facilities to serve mining operations.[72]

Moreover, if Sigmon is allowed to avoid its electric provider based on manipulation of its delivery point, the protection and certainty that the Utility Facilities Act was designed to provide to territorial grants would be diminished, if not significantly eroded. Indeed, this case illustrate the concerns the Commission expressed in *Prince George*.[73] Here, KU had been serving a large

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[69] *Id.* at 18.
[70] *Id.* at 20.
[71] KU states that this amount of revenue is equal to approximately 15 to 20 percent of the total Virginia jurisdictional revenue and will directly impact KU's remaining customers in the form of higher rates. Ex. RMH-1 at 23.
[72] Comments of KU on Hearing Examiner's Report at 4.
[73] *See Prince George*, slip op. at 18.

customer, Sigmon, for a number of years and loses Sigmon to a new supplier, PVEC, with the concomitant loss of revenue and wasteful idling of facilities. Then, shortly thereafter, PVEC finds out that it is unable to meet Sigmon's entire demand, and KU is required to take back part of Sigmon's load, only to again lose that same load at a later time. This is the very kind of uncertainty that the Utility Facilities Act is intended to prevent.

We recognize that PVEC has invested large amounts of monies into serving the facilities at issue and a decision in favor of either party will result in a deleterious financial impact on the other. As discussed in *Prince George*, however, we must decide cases involving service territory disputes in a way that is consistent with the significant protection that is afforded to territorial grants by Virginia law. If the situation were reversed, *i.e.*, if KU was serving customers in PVEC's territory, the law would compel a similar finding in favor of PVEC, protecting the integrity of its service territory.

We expect service to Sigmon in the KU service territory to be transferred to KU within 30 days of the date of the issuance of this Order. Within 45 days of the issuance of this Order, the parties shall file a joint report with the Commission certifying that such transfer has been completed.

KU requested that the Commission fine PVEC for its actions. We decline to do so. Accordingly,

IT IS ORDERED that:

(1) KU's petition for injunctive relief and/ or declaratory judgment is granted.

(2) PVEC's motion to dismiss is denied.

(3) Within 30 days of the issuance of this Order, PVEC shall transfer service provided to Sigmon in KU's service territory to KU and within 45 days of the issuance of this Order, and PVEC and KU shall file a joint report with the Commission certifying that such transfer has occurred.